Australian Shareholders' Association

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COVID 19 decimates Sydney Airport earnings

Company/ASX Code	Sydney Airport (SYD)
AGM date	Friday 21 May 2021
Time and location	11am AEST Virtual meeting
Registry	Computershare
Webcast	Yes www.sydneyairport.com.au/AGM2021 Meeting ID 399-530-261
Poll or show of hands	Poll on all items
Monitor	Julieanne Mills and Benjamin Ferry
Pre AGM Meeting?	Yes with Chair: Trevor Gerber, Director: David Gonski AC, Investor Relations: Rob Catterall and GM Finance: Belinda Shaw

An individual involved in the preparation of this voting intention has a shareholding in this company.

Summary of issues for meeting

Without a doubt, COVID-19 has provided a difficult time for Sydney Airport. Government controls around travel, aimed at containing the virus, and the resulting massive reduction in passenger numbers impacted all business revenue streams including retail revenue, rental revenue and transportation revenue. The additional safety requirements, and the national Code of Conduct on rental abatement added further pressure to an already significantly impacted business.

The board and management responded quickly, maintaining strong liquidity by raising equity and debt, reducing operating expenses and capital expenditure to preserve cash, supporting the government and community by adapting to their needs and providing rental relief to tenants and airlines.

The big question going forward is how long until the new normal of air travel returns and what will the new normal in travel look like?

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required

Summary of ASA Position

<u>Governance and culture</u>

Very positive employee engagement at 80% in 2020 up from 70% in 2019.

Gender diversity decrease from 39% in 2019 down to 35% in 2020.

Achieved a 50:50 KMP gender ratio and pay equity of 99.8% at the close of 2020.

Capital expenditure projects related to future sustainability were completed within 2020. These include the resurfacing of main runways and associated taxiways, the Northern ponds development which will provide air and power to aircraft whilst minimizing noise and emissions. Sydney Airport is committed to be carbon neutral by 2025.

Financial performance

There is not much good news in the financials. COVID-19 has had a significant impact on Sydney Airport (SYD) in 2020 and will continue to have for the foreseeable future, the question is for how long? Revenue was down 51% in 2020 to $803.7m. Passenger numbers were down 75% for the year and 93.4% from the March-Dec period. SYD saw its first loss of -$107.5m. Net operating receipts were down 95% to $45m.

An increase in airfreight (up 124%) and repatriation flights provided some uplift in revenue.

The costs of COVID-19 were shared between the airport, the commercial and retail tenants, suppliers, employees and security holders.

The board and CEO took a 20% pay cut for 3 months from April-June 2020 and guaranteed six months of employment for other employees until September 2020.

Cash collection improved, operating expenses were reduced by 32.8% and only priority capital expenditure was undertaken.

There was no distribution for this financial year, and it is unlikely to return until a sustainable recovery emerges.

Key events

Liquidity was well managed with $850m raised in a bank debt facility in April 2020 and a $2bn Equity raise at $4.56/share in August 2020. With $1.1bn in cash and $2.4bn in undrawn bank debt they remain in a strong liquidity position. Overall debt has been reduced from $9.1bn to $8.5bn from 2019 to 2020.

Expected credit losses jumped from $0.1m to $93.9m with the Virgin Australia losses of $13.8m, rent abatements of $52m, deferrals of $5.2m and impairments against capital projects of $28.2m.

The purchase of jet fuel infrastructure, in October 2020 for $85m, will provide supply competition and assist with attaining sustainable fuels in line with sustainability targets.

Key board or senior management changes

The announcement of David Gonski AC as the new Chairman of SYD is a welcome change. David has a wealth of experience as a Chairman of ANZ, Coca Cola Amatil, and the ASX. He also has experience in the travel industry as a Director of Singapore Airlines from 2006-2012.

The current chairman Mr Trevor Gerber retires at the AGM. The independence of Mr Gerber after 19 years on the board and as chairman from 2015 had been a concern for the ASA for a number of years.

A restructure of roles saw the COO, Hugh Wehby, leave in September 2020, he was not replaced. Dhruv Gupta took on the newly created role of Chief Aviation Officer in September 2020. The CFO, Greg Botham took on expanded responsibilities and his fixed remuneration was increased from $612k to $800k.

ASA focus issues

SYD received $13m in Jobkeeper payments in 2020. Employee expenses dropped by 22%. 118 roles were made redundant. 10,000 local jobs were lost.

Summary

(As at FYE)	2020	2019	2018	2017	2016
NPAT ($m)	-107.5	215	371	348.6	319.6
NOR($m) Net operating Receipts	45.5	905.7	860.9	787.3	675
Share price ($)	6.41	8.66	6.73	7.05	5.99
Dividend (cents)	0	39	37.5	34.5	31
TSR (%)	-26.0	34.7	0.6	23	-1.1
Cash flow per stapled security	1.9	40.1	38.2	35	30.2
CEO total remuneration, Statutory ($m)	1.657	3.38*	4.792	4.818	3.32

- Includes $1.7m one off payment for incentives forgone at previous employer.
- For 2020, the CEO's total actual remuneration was **18 times** the Australian Full time Adult Average Weekly Total Earnings (based on November 2020 data from the Australian Bureau of Statistics
- Actual remuneration is not reported in the Annual Report the ASA would like to see tit reported in future years

Item 2	**Adoption of Remuneration Report**
ASA Vote	**For**

Summary of ASA Position

The ASA has a number of concerns regarding the remuneration report that have been aired in previous years. Last year we voted against the remuneration report. Little has changed. Short Term Incentives (STI) are still paid in Cash with only 20% in deferred cash over two years. The ASA would prefer to see the deferred component in equity and a 50:50 split.

The STI is measured: 50% Financial (NOR and EBITDA), 30% strategic, and 20% people and culture. Financial measures are shared across all KMP with expectations of meeting budget and some growth.

The LTI is measured on 50% TSR (against comparative ASX 100) with vesting starting at the 50th percentile, and 50% CPS (cash flow per stapled security) with vesting occurring after 6% growth. It is measured over 3 years only. This year the CPS measure has been suspended temporarily due to COVID-19 and the inability to predict passenger numbers.

No STI was allocated this year and LTIs are unlikely to vest given the impact of COVID-19 on the company's financial performance.

The introduction of the retention rights payments in lieu of LTIs is a concern for the ASA (see below Item 5).

Considering the CEO and board's 20% pay cut for 3 months, the savings from not replacing the COO and the need to retain key personnel during a very difficult time we feel there is some justification for the retention payments. Ultimately the board is responsible for using its judgement to act in the best interests of the company and in this case COVID-19 has been an exceptional circumstance. It is possibly understandable that there is no change to the remuneration framework when there is such an unknown future but as the situation evolves, we expect the board to address our concerns.

In this instance we will vote for the remuneration report, however we will not hesitate to vote against it in future if the remuneration framework is not improved to further align with shareholder interests.

Remuneration Framework

CEO Remuneration for FY 2020	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	$1.5m	33%	$1.5m	29%
STI - Cash	$1.2m	26.4%	$1.8m	33.6%
STI – deferred cash (20%)	$300k	6.6%	$450K	8.4%
LTI	1.5	33%	$1.5m	29%
Total	**$4.5m**	100%	**$5.25m**	100%

*Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting.

Item 3	**Re-election of Grant Fenn as a Director**
ASA Vote	**For**

Summary of ASA Position

Grant Fenn was appointed a director in October 2015. He is a member of the Nominations and Remuneration Committee and the Safety and Sustainability Committee. He is currently MD and CEO of the ASX listed Downer Group.

As CEO of Downer there are related party transactions that need to be carefully managed with currently $42m in contracts in place between SYD and the Downer Group.

Grant has extensive experience in the air travel industry with past executive committee roles in Qantas, as Chair of Startrack and a Director of Air Express.

While the skills and expertise of Mr Fenn are welcomed the ASA has concerns around Mr Fenn's time and availability given his CEO role with Downer. The Chairman expressed the board's support for Mr Fenn and ensured us that he had been very committed to his role during this year's difficulties.

It is a positive sign that Grant Fenn has purchased 40,000 shares this year and now has a stronger equity stake in the performance of SYD.

Item 4	**Re-election of Abi Cleland as a Director**
ASA Vote	**For**

Abi Cleland was appointed to the board in April 2018. She is a member of the Audit and Risk, and the Nominations and Remuneration committees.

Her current directorships include: Computershare, Coles Group, Orora and Swimming Australia.

Abi's expertise covers strategy, mergers and acquisitions and digital.

Abi Cleland has 17,913 shares and increased her shareholding this year. The ASA would like to see her increase her shareholding to have a greater aligned equity interest with the performance of SYD, above her base fee of $175k. The director's shareholding policy requires the equivalent of one year's fees.

Item 5	**Approval of 407,727 Retention Rights to CEO Geoff Culbert**
ASA Vote	**For**

Summary of ASA Position

These retention rights were granted in Oct 2020 to retain talent and "leadership continuity" during COVID-19, especially given the impact on the company's financials and consequently the reduction in incentive payments to KMP.

There are no performance criteria attached to these other than to stay in the job. The performance period is to October 2023 and will remain on foot and subject to board discretion. The maximum amount for the CEO is $2.25m of share rights purchased on market on vesting and issued at $5.52 based on the VWAP up to the 16 October.

Greg Botham and Vanessa Orth also received retention payments of $1.2m each

No STIs were awarded in 2020. Although the strategic, people and culture areas were met the board felt that the financial impact to company and security holders did not warrant it. We agree.

The ASA does not usually support the use of retention payments. We feel that the shareholders, other employees, and other stakeholders are all sharing the financial pain and three KMP should not be rewarded for just staying in the job. Their fixed remuneration has not been reduced (apart from the CEO's 20% cut for 3 months in March) and remuneration has been increased when their responsibilities have increased. While STI and LTI incentives are unlikely to vest, shareholders are also receiving no dividends and the company has been significantly impacted financially. We also believe that it reflects badly on the culture of the organisation if it requires a retention payment to keep people from leaving.

At the pre-AGM meeting the chairman acknowledged that the retention payments are in lieu of LTIs being paid. They felt that it was the responsibility of the board to retain KMP and ultimately protect the TSR.

The impact of COVID-19 is not the fault of management and the company has performed well considering the constraints placed on it (i.e liquidity management, safety and government requirements). There is relative stability within the company in very difficult circumstances and on balance we felt that the board and management should be supported to maintain this.

For these reasons we are supporting the retention payments, however, we want to see a more long term perspective aligned to shareholders interests in next year's remuneration report and will not hesitate to vote against any further retention payments.

Item 5	**Approval of LTI grant of 182,927 rights to CEO Geoff Culbert**
ASA Vote	**For**

Summary of ASA Position

The CEOs LTI Equity remuneration for 2021 subject to satisfaction or waiver of performance conditions requires a 50% vote.

The allocation of $1.2m is based on $6.56 VWAP 20 days up to 31 Dec 2020. The actual value will be dependent on a three year performance period to Dec 2023. Measured against the rTSR of ASX100 over the 3 years. The previous 50% measure of cents per share growth has been suspended due to the COVID-19 impact on passenger numbers and the difficulty in predicting future numbers.

The minimum 50% is granted at 50th percentile 100% at the 75th percentile. The TSR must be positive for it to vest.

The ASA likes to see two measures in place for LTIs and would prefer to have a four year term while the cents per share measure is difficult to predict in this environment another measure could possibly have been used?

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Appendix 1
Remuneration framework detail

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